

The critique of capital in the 21st century: in search of the macroeconomic foundations of inequalities

By [Guillaume Allègre](#) and [Xavier Timbeau](#)

In his book *Capital in the 21st Century*, Thomas Piketty offers a critical analysis of the dynamics of capital accumulation. The book is at the level of its very high ambitions: it addresses a crucial issue, it draws on a very substantial statistical effort that sheds new light on the dynamics of distribution, and it advances public policy proposals. Thomas Piketty combines the approach of the great classical authors (Smith, Ricardo, Marx, Walras) with impressive empirical work that was inaccessible to his illustrious predecessors.

Thomas Piketty shows the mechanisms pushing towards a convergence or divergence in the distribution of wealth and highlights how the strength of divergence is generally underestimated: if the return on capital (r) is higher than economic growth (g), which historically has almost always been the case, then it is almost inevitable that inherited wealth will dominate built-up wealth, and the concentration of capital will reach extremely high levels: “The entrepreneur inevitably tends to become a rentier, more and more dominant over those who own nothing but their labour. Once constituted, capital reproduces itself faster than output increases. The past devours the future.”

The book thus seeks the basis for inequality in macroeconomics ($r > g$), whereas the usual suspects are found at the microeconomic level. In [OFCE Working document no. 2014-06 \[in French\]](#), we argue that this macro-foundation for inequality is

not convincing and that the same facts can be interpreted using a different causality, in which inequality arises from the operation of (imperfect) markets, scarcity rents and the establishment of property rights. It is not $r > g$ that turns entrepreneurs into rentiers, but the establishment of mechanisms that allow the extraction of a perpetual rent that explains the historical constancy of $r > g$.

This different interpretation of the same phenomena has consequences for public policy. The *ex post* taxation of capital, where necessary, can only be a second-level choice: first the constraints of scarcity have to be removed and the definition of property rights and the rights of owners and non-owners must be defined. Are landlords going to be free to charge any rent they like? Can they limit other construction around their property? How much protection is labour law going to give workers? To what extent can they influence managerial decisions within the company? In our opinion it is the answers to these questions that determine the relationship between economic growth and the return on capital, as well as capital's weight in the economy. The point is to prevent owners of capital from exploiting a favourable balance of power. In this respect, while its shape has changed, capital in the twenty-first century is much like it was in the late nineteenth century. Dealing with it will require more than a tax on capital.

For more information, see: "La critique du capital au XXI^e siècle : à la recherche des fondements macroéconomiques des inégalités", [**Document de travail de l'OFCE, n°2014-06**](#).

How many euros per job created?

By Guillaume Allègre, [@g_allegre](#)

The Responsibility Pact, the CICE competitiveness tax break, reductions on social security charges ... is it possible to reduce the evaluation of such measures to the cost in euros of each job created? While such an assessment is obviously important, the final figure is often subject to misinterpretation or misuse in the public debate, sometimes in perfectly good faith. For some commentators, a very high cost per job created, generally higher than the average real cost of a public (or private) job, represents a waste of public money that would be better used elsewhere, for nurseries, education or the national police.

This kind of logic is based on a misinterpretation of the billions involved. To understand this, let's do the following thought experiment: take two tax measures, *A* and *B*, which are intended to reduce the cost of labour in order to generate jobs. Measure *A* creates 200,000 jobs and costs the State and government *ex post* (that is to say, after taking into account the jobs created and interaction with the social security and tax systems) 20 billion and 1 euros. The cost per job created is thus 100,000 euros, which seems excessive. Measure *B* creates 180,000 jobs and has an *ex post* cost of 20 billion euros, 111,111 euros per job, which is even worse. At first glance, there's no point in implementing either Measure *A* or *B*: the cost per job created is far too great. Now, suppose it is also possible to enact Measure $-A$ or $-B$ which, conversely to *A* and *B*, push up the cost of labour (through higher payroll taxes) with symmetrical effects on employment. Suppose also that the impact on employment and the cost are additive when two measures are implemented at the same time. It now seems clear that we should implement $[A-B]$ ^[1]: reducing the cost of

labour by A and increasing it by $-B$ would create 20,000 jobs for a cost of 1 euro, or 0.00005 euros per job created! The ratio of the cost of a job created between Measure A and Measure $[A-B]$ is 2 billion to 1 ($= 100,000/0.00005$)! Someone not paying attention might then say: Measure A must certainly not be implemented.

	Number of jobs created	Ex post cost of the measure	Cost per job created
A	200 000	20 000 000 001	100 000
B	180 000	20 000 000 000	111 111
$[A-B]$	20 000	1	0,00005

Since Ricardo, economists have known that it is often the relative advantages that count and not the absolute advantages: alone, A is not of much interest, but combined with $-B$ it is very powerful, just as in poker a 2 of Hearts in a hand does not have the same value when it is with Jacks as when it is with the 2s of Spades, Clubs and Diamonds. Economic policy measures cannot be evaluated in isolation: they must be evaluated in their interaction with all the instruments that have already been implemented or are simply there.

In addition to the failure to take into account macroeconomic dynamics and the financing, another limitation of reasoning in terms of cost per job created is that it does not always consider the questions: who pays the bill, and who gets what? Expenditures by the State (for childcare, education or the national police) are not equivalent to tax expenditures: if they are funded, the former reduce the disposable income of households, while the latter do not (they are a transfer between households, between businesses or between households and businesses). As a consequence, it is misleading to compare the two types of expenditure only in terms of jobs created. In effect, the jobs created are simply an indirect consequence of a tax expenditure (the direct effect is the transfer from the State to households and businesses); if the measure is funded, as in $[A-B]$, the jobs created are a second-order effect related to the different behavioural responses to A and $-B$. In

contrast, a structural increase in government spending (and therefore in the tax burden) has the first-order effect of increasing the consumption of public goods and reducing the consumption of private goods. If you reason only in terms of jobs, there is a risk of ending up with full employment but in a completely socialized economy. To evaluate this type of transfer, parameters other than job creation also need to be considered. In particular it is necessary to take into account well-being (what is the utility of nurseries or spending on education and national police versus private spending?) and incentive effects (what is the effect of higher social contributions on economic incentives to meet consumer needs?). It is also necessary to think in terms of the tax burden. [A-B] can create jobs only by organizing transfers within households and / or businesses. The relevant questions are therefore: who are the *ex post* winners and losers (taking into account the jobs created and changes in prices and wages)? Do these transfers reduce or increase inequality? Do they violate horizontal equity (equal taxation on equal abilities to pay)? Are they likely to affect long-term growth (via the structure of employment, capital-labour substitution, etc.)?

And what if the ECB respected its mandate!

By [Christophe Blot](#)

Article 127 of the Treaty on the Functioning of the European Union (TFEU), *i.e.* former Article 105 of the Maastricht Treaty, states clearly that “the primary objective of the

European System of Central Banks ... shall be to maintain price stability". However, no precise quantification of this goal is given in the Treaty. The European Central Bank has interpreted this by stating that it would target inflation that is below, but close to, 2% over the medium term. Furthermore, Article 127 of the TFEU adds that, "without prejudice to the objective of price stability , the [European System of Central Banks] shall support the general economic policies in the Union, as laid down in Article 3 ...", which includes in particular the sustainable development of Europe based on balanced economic growth and price stability, full employment and social progress. It is therefore clear that the goal of growth and employment is not abandoned but subordinated to the goal of price stability. Starting from this review of the definition of the ECB's objectives, what conclusion can we draw on the orientation of monetary policy in the euro zone?

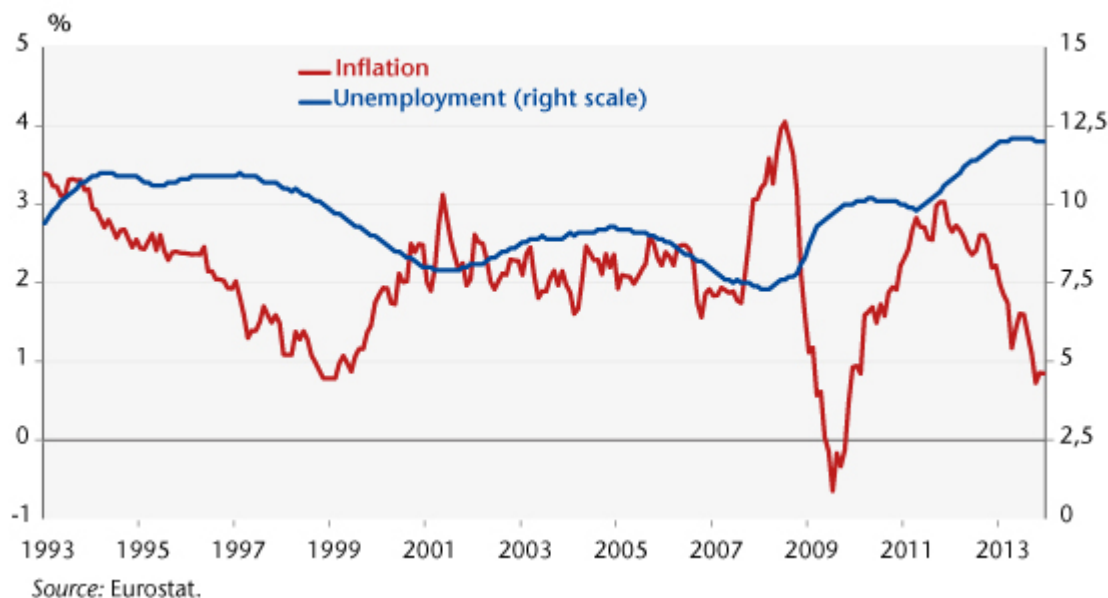
Since the end of 2013, a few signs of economic recovery have appeared in the euro zone. Initial estimates of growth in the fourth quarter of 2013 have confirmed that the recession is ending, with GDP up 0.3%. Nevertheless, the economy is still in poor health. As proof, simply recall that 12% of the labour force is currently unemployed, which is the highest level since 1993 (see chart). Growth is expected to accelerate in 2014 and 2015. According to the ECB forecasts announced in March 2014, growth will hit 1.2% in 2014 and 1.5% in 2015, a pace that is still insufficient to lead to a rapid or significant reduction in the unemployment rate. In addition, since the end of 2013 inflation has dropped below the threshold of 1% and is coming dangerously close to a point where deflation is a risk. Furthermore, still according to the ECB forecasts, inflation should not exceed 1.0% in 2014, before pushing up to 1.3% in 2015 and 1.5% in 2016. It is in any case far from the mid-term target of 2%. The objective of price stability as defined by the ECB will therefore not be met. At his press conference in March, Mario Draghi announced that the maintenance of the ECB key interest rate [\[1\]](#) at 0.25%

and the absence of additional (so-called unconventional) measures could stimulate the euro zone. The status quo was justified by the absence of signs of a more rapid fall in inflation. By taking this stand, the ECB President is indicating that he is satisfied with a situation where inflation remains permanently below the 2% level and where the euro zone is marked by persistent mass unemployment. Are we therefore supposed to reinterpret the definition of price stability invoked by the ECB and accept that the term *below* is more important in the eyes of the members of the ECB Governing Council than the term *close to 2%*? The answer to this question is obviously not neutral, since it would reflect a certain asymmetry in the central bank's reaction to inflation, with the ECB reacting more quickly when inflation exceeds 2% than when it falls below 2%, including over the forecast horizon of its own team. But however its main objective is interpreted, the fact remains that the risk to price stability is not currently a barrier to the implementation of a more expansionary monetary policy. In these conditions, the ECB has all the room it needs to be actively concerned about its other objectives, including first of all growth and unemployment.

So what tools does the ECB have available, knowing that with the benchmark rate at 0.25% it has only very limited manoeuvring room for a downward adjustment? The ECB must therefore use other levers. Communication by the central banks has played an increasing role in the implementation of monetary policy, as this can be used to influence agents' expectations and hence the impact of decisions on inflation and growth. In this respect, the central bank has recently (July 2013) engaged in what is called forward guidance by stating that the key rate will be maintained at a low level for an extended period [\[2\]](#). The ECB could go further by conditioning a hike in the key interest rate on a target unemployment rate, as both the Bank of England and the Federal Reserve have done; this would give added substance to its objectives on employment and growth. In addition,

unconventional measures could be used to strengthen the expansionary character of monetary policy. This mainly means measures that alter the size or composition of the central bank's balance sheet, which would supplement the role of the reduction in short-term rates in influencing financing conditions. A recent report by France's Council of Economic Analysis (see [here](#)) points in this direction, and in particular proposes that the ECB should purchase securitized small and medium enterprises' (SME) loans in order to reduce the cost of business financing. The Outright monetary transactions (OMT) programme [3] could have been activated to support the reduction in long-term sovereign rates. The announcement of this measure did indeed contribute to lowering long-term sovereign rates in Spain and Italy, in particular because it sent a signal that the risk of collapse of the euro zone was being averted. Up to now, the ECB has not intervened in the markets to buy government securities. Yet given its unlimited capacity for intervention, doing this would help to reduce long-term rates. Note, however, that the OMT programme is currently being challenged by Germany's Constitutional Court in Karlsruhe, which has questioned the programme's constitutionality, with the case being referred to the European Court of Justice. A rejection or restriction of the ECB's actions in this matter would be unfortunate. The ECB's scope for intervention does of course need to be clarified. But it is also essential to retain the objectives of price stability and growth. The judges in Germany and at the European Court of Justice would be well advised to keep this in mind.

Figure. Unemployment rate and inflation rate in the euro zone



Revising the budget in Croatia: yes, but ... for whom and why?

By [Sandrine Levasseur](#)

Under the [excessive deficit procedure that Croatia has been subject to since 28 January 2014](#), the country's government has been obliged to revise its projected budget for the forthcoming three years, which is the timeframe that has been set for putting its finances into "good order", with "good order" being understood to mean a public deficit that does not exceed 3% of GDP. This new budget is being fixed in adverse economic conditions, as the government's forecast of GDP growth for 2014 has been revised downward from 1.3% to a tiny 0.2%.

Paradoxically, the new budget could help prolong the recession

in the country rather than help it recover, at least in 2014. This paradox is especially worth noting since this is also the opinion of those for whom the Croatian government is making this adjustment: first of all, the [rating agencies](#), and second, the international institutions (or at least [the IMF](#), as the European Commission has to keep quiet on the matter). In fact, a simple glance at the revised budget is enough to see that the fiscal adjustment being proposed by the Croatian government will not have an expansionary impact on GDP. For example, the budget provides for a hike in tax revenues, in particular through an increase in the rate of health insurance contributions from 13% to 15%. But this will also result in undermining the [international competitiveness of the country's businesses](#), which have already been hit hard.

The wages and bonuses of civil servants will fall (by about 6%) so as to give the public finances some breathing room. But these cuts in civil servant salaries will not help perk up domestic demand, which has been anaemic due to the [adjustments consumers and businesses have made in their balance sheets](#). To take the latest example, to help bail out the state finances the profits of state enterprises will not be reinvested in the economy. However, the country is thereby depriving itself of a source of growth since, because of their weight in the economy, these enterprises account for a large [share of productive investment](#).

There is no doubt that Croatia's public finances need to be cleaned up. However, the horizon for the fiscal consolidation decided on by the Croatian government seems to us extremely "short-termist", as it doesn't call into question the existing model of growth or seek sources of sustainable growth. A few weeks ago, in an [OFCE note](#) we discussed the impact alternative fiscal adjustments would have on growth and the public finances. In the specific [case of Croatia](#), the government cannot avoid the need to consider doing the following: restructuring the productive apparatus (including through

privatization and concessions); improving the system of tax collection; and, more broadly, implementing an anti-corruption policy to improve the country's "business climate". In the meantime, in large part due to the fiscal decisions being taken, 2014 is likely to wind up as the sixth year in a row Croatia has been in recession. The IMF forecasts, which anticipate that the recessionary impact of the fiscal consolidation will be greater than that projected by the Croatian government, [is expecting GDP to fall by about 0.5% to 1%](#) in 2014. In total, the decline in GDP since 2009 will therefore come to between 11.6% and 12.5%. It's not exactly the stuff of dreams...

Should we be celebrating the fall in unemployment at end 2013?

By [Bruno Ducoudré](#) and [Eric Heyer](#)

Every quarter, the INSEE publishes the unemployment rate as defined by the International Labour Office (ILO): for the fourth quarter of 2013, it **fell** 0.1 point in France, meaning 41,000 fewer unemployed. Likewise, every month the number of jobseekers registered with the Pôle Emploi job centre is reported: during the fourth quarter of 2013, this source indicated that the number of registered jobseekers in category A **rose** by 23,000. In one case unemployment is down, in the other it is up – this does not lead to a clear diagnosis about where unemployment is heading at year end.

What explains the difference in diagnosis between the INSEE and Pôle emploi?

Besides differences related to methodology (an employment survey for the ILO, an administrative source for Pôle emploi), it should not be forgotten that, according to the ILO, a person must meet three conditions to be counted as unemployed: being unemployed, being available for work and performing an active job search. Simply being registered at Pôle emploi is not sufficient to fulfil this last condition. So people registered as category A at Pôle emploi who are not actively seeking work are not counted as unemployed according to the ILO. The ILO criteria are thus more restrictive. Historically, for those aged 25 and over, the number of unemployed registered at Pôle emploi is greater than the number according to the ILO criteria. For those under age 25, registering with Pôle emploi [1] is in general not as worthwhile, except during a period of active social treatment of unemployment, as was the case during the last quarter of 2013: people who wanted to benefit from a subsidized job had to be registered at the job centre.

Table 1. Change in the number of unemployed from Q3 to Q4 2013

1000s

Age	15-24	25-49	50 +	Total
Unemployed (ILO criteria)	-33	3	-11	-41
Registered at Pôle emploi Cat. A	-7	10	20	23
Difference	26	7	31	64

Sources: INSEE, Emploi survey, Pôle emploi DARES.

As shown in Table 1, regardless of the age group, the situation seems less favourable using the Pôle emploi figures than according to the ILO criteria: when confronted with more than 2 years of unemployment, a certain number of discouraged jobseekers stop their active job search and are thus no longer recognized as such within the meaning of the ILO, yet continue to update their status at the job centre, and therefore remain listed in Category A.

Is the reduction in the unemployment rate calculated by ILO criteria good news?

The unemployment rate can fall for two reasons: the first one, virtuous in nature, is as a result of escaping unemployment due to improvements in the labour market; the second, less encouraging, is due to jobless people becoming discouraged and drifting into inactivity. The latest statistics from the ILO emphasize that the 0.1 point fall in the unemployment rate can be explained in full by the fall in the participation rate – which measures the percentage of the work force in the population aged 15 to 64 – and not by a resumption of employment that has remained stable. The decline in the unemployment rate is thus not due to a recovery in employment, but to discouraged jobless people who quit actively seeking employment (Table 2).

Table 2. Breakdown of the change in the labour force participation rate (ILO criteria) Q4 2013

In points

Age	15-24	25-49	>49 ans	Total *	Labour force Q4 2013 (1000s)
Employed	0,3	-0,2	0,2	0	25 547
Unemployed	-0,5	0	-0,1	-0,1	2 784
Labour force	-0,1	-0,1	0,2	-0,1	28 331

*The employment rate, the unemployment rate and the labour force participation rate are average rates weighted for the number of individuals in each age group. The 25-49 age group is the largest, representing about 60% of the total. Source: INSEE, Emploi survey.

Looking more closely, the employment policy pursued by the government – “jobs for the future”, CUI “unique integration contracts” – has had a positive impact on youth employment; the employment rate rose by 0.3 percentage point during the last quarter of 2013. Among seniors, the employment rate is still continuing to rise (+0.2 percentage point) due to the decline in the actual age of retirement. ILO-defined unemployment is of course falling among seniors, but the sharp rise in enrolment at the job centre in this age group (Table 1) undoubtedly reflects a change in their job search behaviour: more and more seniors are no longer looking for work. They are now included in the “halo” of unemployment,

which is continuing to rise.

Ultimately, the fall in the ILO-defined unemployment rate, which is characterized by the absence of a recovery in employment and the discouragement of jobseekers, is not such good news.

[\[1\]](#) To have the right to unemployment compensation and receive assistance for a return to work, it is necessary to prove a 122 day contribution period or 610 hours of work during the 28 months preceding the end of the job contract.

Central banks and public debt: dangerous liaisons?

By [Christophe Blot](#)

Since 2008, monetary policy has been in the forefront of efforts to preserve financial stability and stem the economic crisis. Though the Great Recession was not avoided, the lessons of the crisis of the 1930s were learned. The central banks quickly cut short-term interest rates and have kept them at a level close to zero, while developing new monetary policy instruments. These so-called unconventional measures led to an increase in the size of balance sheets, which exceed 20% of GDP in the United States, the United Kingdom and the euro zone and 45% in Japan. Among the range of measures employed was the central banks' purchase of public debt. The goal was to lower long-term interest rates, either by signalling that monetary

policy will remain expansionary for an extended period, or by modifying the composition of the asset portfolios held by private agents. However, the Federal Reserve recently announced that it would gradually reduce its interventions ([see here](#)), which could cause a rapid rise in interest rates like that seen in May 2013 (Figure 1) upon the previous announcement of this type. In a context of high public debt, interest rate dynamics are crucial. The central banks need to take into account the enhanced interaction between monetary and fiscal policy by coordinating their decisions with those taken by governments.

In normal times [\[1\]](#), monetary and fiscal policy pursue common goals, foremost among them macroeconomic stability. There are therefore interactions between the decisions taken by the two authorities. A tightening of monetary policy via an increase in interest rates could for instance counteract a fiscal expansion, and vice versa. It is thus necessary to coordinate economic policy in order to ensure the best macroeconomic balance. The implementation of unconventional monetary policy measures enhances these interactions. The adoption of unconventional measures has led central banks to buy government debt, to such an extent that, with the exception of the ECB, these banks hold a significant portion of the outstanding debt (Figure 2). In doing this, their operations are interfering with the management of debt, which is usually vested in the Treasury. The link between monetary policy and debt management is not new, though it receded as central banks became independent institutions with a primary objective of price stability, which they seek to achieve exclusively by changing the key interest rate. Goodhart [\[2\]](#) (2010) clarifies that this role was historically devolved on them. Nevertheless, the objectives of the central bank and of the agency responsible for issuing public debt may be contradictory (Blommestein and Turner [\[3\]](#), 2012), as the Treasury seeks to minimize the cost of debt service, regardless of the macroeconomic impact of its decisions. Two

additional interactions can emerge. On the one hand, the government may partially counteract the central bank's actions on long-term rates by seeking to profit from their decline through additional issues on the maturities targeted by monetary transactions. The excess demand is then partially absorbed by an additional supply for a given maturity. This is what has happened in the United States, as the average maturity of the debt rose from 48.5 months in October 2008 to 64 months in May 2012. Recent work by Chadha, Turner and Zampolli [\[4\]](#) (2013) suggests that this policy of managing the maturity of the public debt supply has a significant impact on interest rates. The [minutes](#) of the US Treasury meeting on 2 November 2010 illustrate the potential conflict between objectives: "It was pointed out by members of the Committee that the Fed and the Treasury are independent institutions, with two different mandates that might sometimes appear to be in conflict. Members agreed that Treasury should adhere to its mandate of assuring the lowest cost of borrowing A couple [of] members noted that the Fed was essentially a 'large investor' in Treasuries and that the Fed's behavior was probably transitory. As a result, Treasury should not modify its regular and predictable issuance paradigm to accommodate a single large investor."

On the other hand, the reduction in the portfolio of government securities held by the central bank should lead to higher long-term rates. This is in any case what is suggested by some of the recent literature on the impact of unconventional monetary policies. The dynamics of bond yields observed in May 2013 (Figure 1), the first time that the markets anticipated [\[5\]](#) a steady decline in purchases by the Federal Reserve, shows that the increase may be rapid and cause high volatility on the financial markets. The explanation for this increase may be related to the end of or the unwinding of arbitrage operations carried out by investors who took advantage of low long-term interest rates in the industrialized countries in order to take on debt and

seek more profitable investments in other markets, in particular the emerging markets. The consequences of such a scenario must be taken into account by the central banks. If the conduct of monetary policy involves making fewer central bank interventions, then the impact on debt service of this pull-back needs to be factored in. Despite the process of public debt reduction, government financing needs will stay high, and additional refinancing costs due to higher interest rates could lead States to strengthen fiscal consolidation, which would have adverse effects on economic activity. Conversely, the maintenance of low interest rates could greatly contribute to facilitating fiscal adjustment by allowing low-cost refinancing and by giving a stimulus to the economy, thereby reducing the recessionary impact of the fiscal adjustment.

Due to the nature of these interactions, to a macroeconomic context marked by a high level of public debt, and to the risk of financial instability, it is essential to coordinate monetary and fiscal policy. This necessity is illustrated perfectly in the case of the United States in an observation by James Tobin quoted by Turner^[6] (2011): “The Federal Reserve cannot make rational decisions of monetary policy without knowing what kind of debt the Treasury intends to issue. The Treasury cannot rationally determine the maturity structure of the interest-bearing debt without knowing how much debt the Federal Reserve intends to monetize.”

In Europe’s case, this seems to be a second-order question, since the ECB has a small portfolio of assets (Figure 2). While taking note that this portfolio is concentrated on bonds issued by certain countries (Italian, Spanish, Portuguese, Greek and Irish), whose public debt represents 42% of euro zone debt, the outstanding debt held by the ECB comes to 5% when considering only the countries in crisis. It’s regrettable that the ECB has not taken a more active monetary policy, which would have made it possible to effect a major

uniform reduction in interest rates in all the euro zone countries, which would have helped to reduce the need for fiscal consolidation and mitigate its negative effects.

Figure 1. Interest rates on long-term public debt

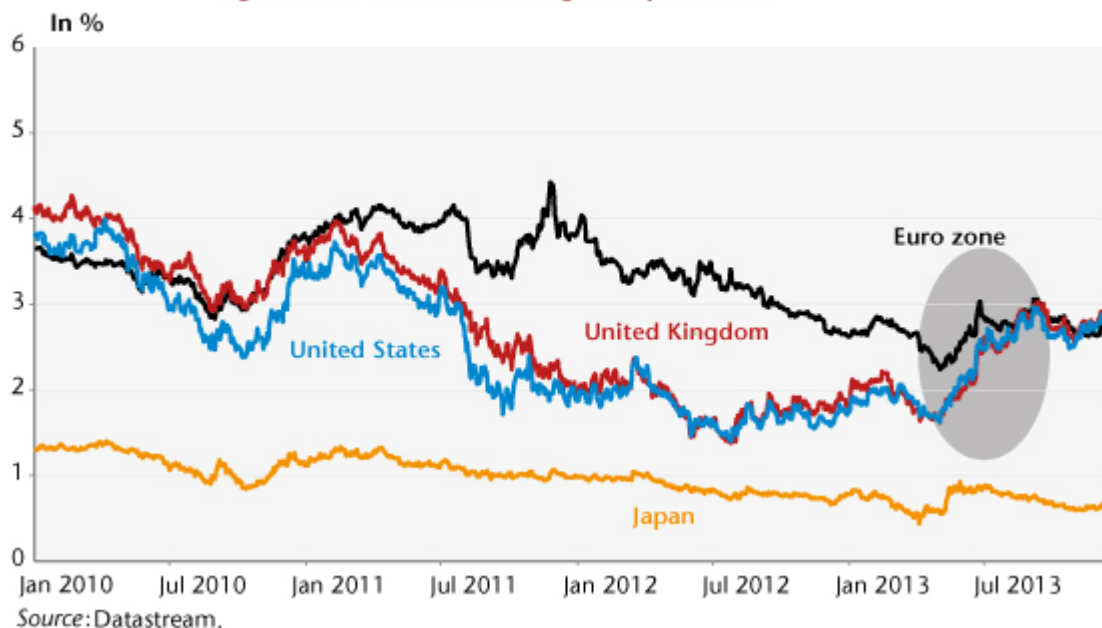
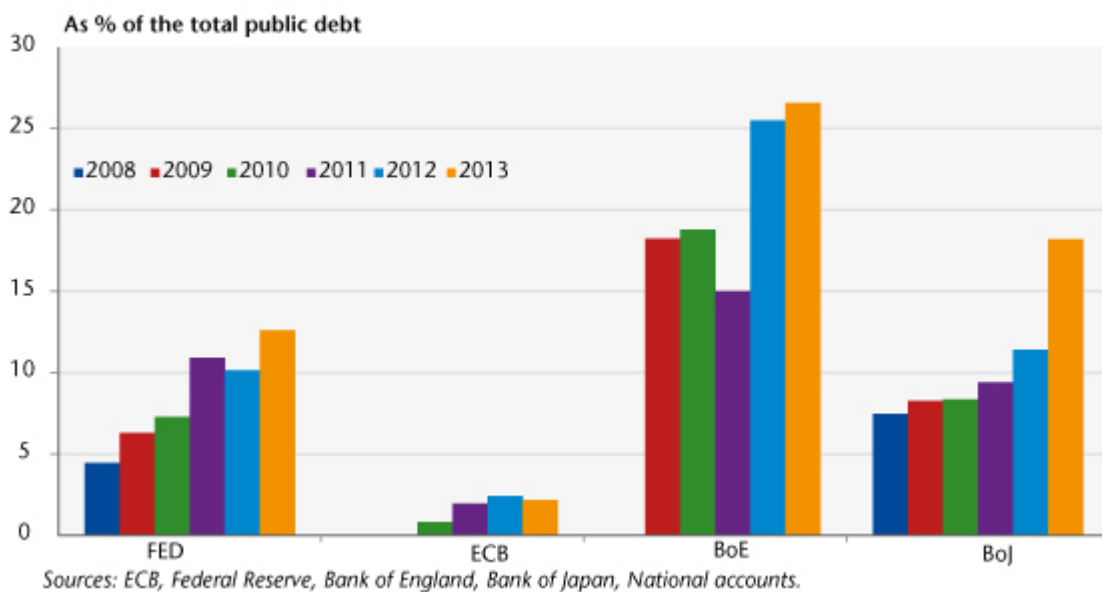


Figure 2. National public debt held by the central banks



[1] Here the expression “in normal times” refers to the fact that the conduct of monetary policy is usually characterized by decisions taken by the central banks on the key interest rate, which is a short-term rate. During the crisis, the central banks set this key rate at a very low level, near to the zero lower bound, and so turned to new measures to strengthen the expansionary character of monetary policy.

[2] See “[The changing role of central banks](#)”, *BIS Working Paper* no. 326, November.

[3] See “[Interactions between sovereign debt management and monetary policy under fiscal dominance and financial instability](#)”, *OECD Working Paper* no. 3.

[4] See “[The interest rate effects of government debt maturity](#)”, *BIS Working Paper* no. 415, June.

[5] These expectations were initially fuelled by the improving jobs situation in the United States and then by Ben Bernanke’s statement confirming a possible pull-back by the Federal Reserve. These elements are described in more detail by the BIS in its [Quarterly Review](#), September 2013.

[6] See “[Fiscal dominance and the long-term interest rate](#)”, 2011, *Financial markets group special paper series* 199, May.

The responsibility pact’s

obligation of a result

By [Xavier Timbeau](#), @XTimbeau, OFCE

The original French text was published in the "Rebonds" section of the newspaper Libération on 28 February 2014.

Is the policy supply-side or demand-side? This debate takes us back decades to a time when the advocates of supply-side policy, Ronald Reagan and Margaret Thatcher, wanted to put Keynesian practices into the closet. With respect to the responsibility pact, the debate is moot. There is a clear diagnosis that companies are suffering from such low margin rates that their very survival is threatened. The losses of market share since the 2000s cannot be explained solely by the transition to a post-industrial society. It is thus a priority to boost corporate margins by whatever means necessary. But the restoration of business margins will not be sufficient to put them back on a path of increasing productivity, ensuring their competitiveness in the medium term. Getting back on this path will require numerous reforms, ranging from a better education system to a stable tax system that is as neutral as possible, while making use of the impact of agglomeration and specialization. Coordinating everyone's projects around a comprehensive strategy to make the energy transition is also a powerful instrument. But the responsibility pact remains silent on this.

To be clear, the responsibility pact aims to improve the situation of business, which could partially offset the decline in activity resulting from the 2008 crisis and the French economy's loss of competitiveness relative to its partners undergoing deflation (including Spain) or due to a rise in the euro. In so far as the pact is financed by taxes or spending cuts, this will constitute a tax depreciation, which will make consumers, employees and those on social

benefits pay for the reduction in business costs. When the decrease in the cost of doing business is more focused on lower wages, then we can expect the creation of something like 130,000 jobs in five years, taking into account the financing (see for example the [article by Heyer and Plane in the revue de l'OFCE no. 126](#)). The counterparties, the support of the trade unions and the MEDEF employer association and the general mobilization around a shared bleak diagnosis, will not lead to the revolution that some expect, but it is part of the solution.

A fiscal devaluation at a time when the countries of southern Europe are flirting with deflation and everyone is chasing after a balanced current account, including by curbing domestic demand, will of course not lead the euro zone out of crisis, but instead keep it in prolonged stagnation. Fiscal devaluation is not the right policy for Europe. But so long as Europe has no path other than mass suicide, then fiscal devaluation is the logical response for France.

130,000 jobs will not be sufficient to reverse the trend in unemployment. In the face of the more than one million additional unemployed since 2008, it is downright derisory. But the responsibility pact could be something other than a fiscal devaluation. The obligation of a result, namely to reduce unemployment, does not leave much choice. For the responsibility pact to be accompanied by a significant reduction in unemployment, the key is not to finance it. The proposal to be made to our partners consists of laxity on our public deficit trajectory in exchange for reforms that everyone would consider structural. Public spending cuts, favourable taxation of business, the prioritization of competitiveness, are all measures that can generate some manoeuvring room.

France has made a commitment to Brussels to reduce its structural deficit by 50 billion euros. If this fiscal effort is made by 2017, almost 1 point of growth will be lopped off

every year, and unemployment will virtually not decline at all by 2017. In fact, only the public deficit would be reduced, to 1.2 percent of GDP; this would open up very favourable prospects after 2017, since the public debt will fall without further budgetary cuts and therefore without hindering the decline in unemployment. It's a comfortable scenario for François Hollande's successor, assuming there is one, as they can even use the situation to lower taxes for the rich. With a combination of lower taxes, lower unemployment and a declining public debt, it will look like a "magician" has succeeded an "incompetent".

On the other hand, using the flexibility offered by the 50 billion euros, that is to say, renouncing the 50 billion goal for structural deficit reduction, would yield a very different result. Simulations at the OFCE indicate that unemployment could be cut by nearly 2 points by 2017. Admittedly, the structural deficit would remain unchanged, but the public deficit, what we see, would be on a downward trajectory: in 2017, it would come to just over 2 GDP points (against 4.2 points at end 2013), bringing the public debt into the region of a reduction in the debt-to-GDP ratio. The situation on the eve of the presidential election would be better, and the voting more open.

To develop this manoeuvring room, our partners (and the European Commission) need to be convinced of just how drastic the situation is. The results of the European elections are likely to remind them and make the obligation of a result clear to all.

Reagan had a great ability to look towards fiscal policy for the motor of his supply-side policy. He thus created the myth that lowering taxes on the rich is good for growth, with consequences for inequality that we are still seeing today. Thatcher believed until the end that reducing the public debt was the right policy. This merely prepared the ground for Tony Blair a few years later. This is the way that political cycles

are made, based on results. In the same way, we are responsible for the long-term consequences of the choices we make today.

Growth in the 4th quarter of 2013, but ...

By Hervé Péléraux

According to the [OFCE's leading indicator](#), the French economy has grown by 0.5% in the fourth quarter of 2013. This result, which was anticipated, reflects the improvement in business surveys seen for about a year now. However, does this mark the return of GDP to a path of higher long-term growth? It is still too early to say.

The improvement in the business surveys anticipated the interruption in the second recession that took place in the first half of 2011. The national accounts then validated the signal emitted by the surveys, with renewed growth of 0.6% in the second quarter of 2013 (Table). GDP did of course fall again in the third quarter (-0.1%), but on average over the last two quarters there was growth of approximately 0.2% per quarter, a rate that, though very moderate, was still positive.

At the same time, the leading indicator, which aims to arrive at an estimate of GDP growth in the very short term by translating the cyclical information contained in the surveys, also pointed to a slow recovery in activity: on average over the last two quarters, growth was estimated at 0.1%, a figure

that is slightly under the assessment of the national accounts.

Table. Rate of growth of French GDP according to the national accounts and the indicator

In %, Q/Q-1, chained prices, base 2005

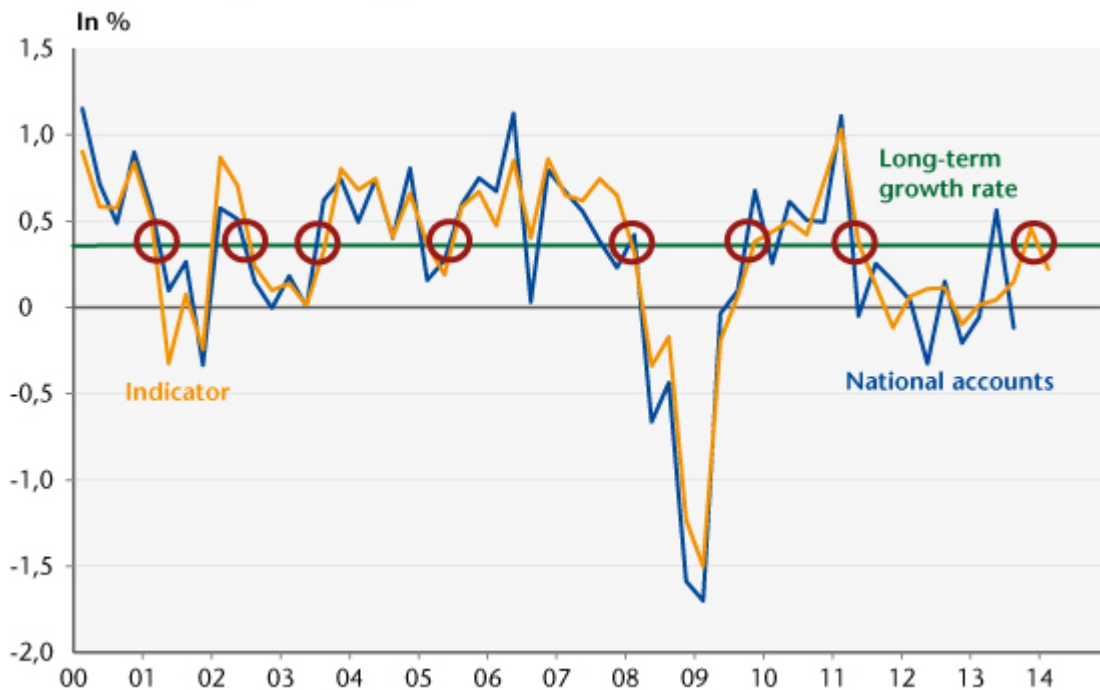
	2012	2013				2014
	Q4	Q1	Q2	Q3	Q4	Q1
National accounts	-0,2	-0,1	+0,6	-0,1	-	-
Indicator	-0,1	0,0	0,0	+0,1	+0,5	+0,2

Sources: INSEE, European Commission, OFCE calculations.

In the last few months, the uncontested growth in the confidence of private agents has enhanced the outlook for the end of 2013: the debate is now focusing on the possibility for the French economy to break through a turning point upwards and for growth to settle in at a level higher than the pace of long-term growth (0.35% per quarter).

Based on past experience, when the indicator has sent out warning signs of a turning point in the economic cycle, the signal issued for the fourth quarter of 2013 is indicating that the long-term growth rate of the French economy is being crossed (Figure). This signal is fragile: the still very partial information on the first quarter of 2014, i.e. the business surveys for January, point towards the growth rate falling below its potential. The possibility of a real lasting recovery that is able to create jobs and reverse the trend in unemployment is thus still very uncertain.

Figure. GDP growth – estimated and forecast



Sources: INSEE, European Commission, OFCE calculations.

Note on the leading indicator:

The leading indicator aims to forecast the quarterly growth rate for French GDP two quarters beyond the latest available data. The components of the indicator are selected from survey data sets that are rapidly available and unrevised. The selection of the data series is made on an econometric basis, starting from the business surveys carried out in different productive sectors (industry, construction, services, retail) and among consumers. Two series related to the international environment are also significant: the rate of growth of the real exchange rate of the euro against the dollar, and the real growth rate of oil prices.

Some components are at least two quarters in advance and as such can be used to predict GDP growth. Others are coincidental, or are not sufficiently advanced to make a forecast two quarters ahead. These series need to be forecast, but over a short-term horizon that never exceeds four months.

The leading indicator is calculated at the beginning of each month, shortly after the publication of the business and consumer surveys.

Why not Sundays – but at what price?

By [G rard Cornilleau](#)

With respect to opening DIY stores on Sundays, one aspect of the issue has never been raised. It nevertheless concerns the majority of customers who shop on weekdays during the day. If stores keep their doors open late or outside traditional work days, the labour costs will rise and the structural costs will fall. The rise in cost is due to the wage compensation to be paid to employees who agree to work outside normal hours. It is now clear that such compensation is necessary. The current discussions between the trade unions and the high street chains will undoubtedly lead to an increase in compensation, with wages likely to be doubled for those working Sundays. Evening work, after 9 pm, will also be compensated. Otherwise, the number of “volunteers” is likely to fall drastically. Nor does anyone really want to argue about whether such compensation is “fair”[\[1\]](#). The reduced structural costs (due in particular to lengthening the duration of capital utilization) should be accompanied by a redistribution of business between neighbourhood shops and the large retailers: as it is unreasonable to expect a higher volume of sales[\[2\]](#), the extension of hours should strengthen the trend towards business concentration, with fewer stores open longer. From

the perspective of well-being, this development should be favourable to those who want to shop outside normal times, and can, and unfavourable to those who prefer to do without a local service on a human scale, or would find it difficult to do so, such as the elderly.

This raises the issue of compensating “loser” customers who do not wish to shop outside traditional hours or in less accessible stores. It is not acceptable that in the absence of price discrimination, the customers who demand to be served at night or on Sundays are subsidized. This existence of an implicit subsidy like this is also unjustified from a strictly economic perspective: in order for consumer choices not to be biased, they must bear the cost of the service they want. In other words, Sunday and late night consumers should pay a fair price for the service they use, and the extended hours should not come at the expense of other consumers [3]. Fortunately, there is a simple solution to this problem: a mandatory fixed coefficient could be applied to the price of purchases made after 9 pm or on Sundays [4]. From then on consumers can choose freely whether to buy during normal hours at the current rate, or outside these hours at the higher rate. Detailed statistical work would be needed to determine the amount of the increase, but it is possible to give an order of magnitude: since trade margins are close to 1/3 and payroll accounts for about 60% of the cost of the business operations, a minimum increase of approximately 15% would be required to account for the doubling of wages on Sundays and after 9pm. Furthermore, to compensate for the potential loss of well-being due to the impact of non-standard shopping hours in the commercial facilities, a coefficient of 20% seems reasonable. Once store customers pay for the extra service they want, i.e. shopping on Sundays or evenings, it would be possible to agree for traders to freely choose whether or not to open, under the same conditions as today of paying compensation and of verification of the “voluntary” nature of the work outside standard working hours. Based on customers’ response to this

price discrimination, the store's choice of whether to open would be made on a rational basis, without penalizing those that do not do business outside regular hours.

This solution is extremely easy to apply since it would involve only a very slight change in the software coding of store tills. It would also be very easy to verify implementation. It is compatible with greater business freedom and fair compensation for employees. Nevertheless, this could still be opposed for moving in the direction of disrupting social time, which could be avoided only by binding regulations. It seems to me that this could nevertheless be tried out so as to accurately measure the need for opening stores outside "normal" hours: if there are still many takers despite a 20% hike in the bill, then that would indicate a substantial need for longer opening hours. Otherwise, there could be a return to a more satisfactory situation where some stores (or parts of stores) open to meet marginal demand, with most business, and therefore most working time, still focused on the traditional work week and working hours.

[1] Many professions charge premium rates on Sundays without anybody questioning the legitimacy of this practice. This is particularly the case of the medical profession. If sometime in the future work on Sundays were to become "commonplace", the Sunday price increases could be called into question, including for those professions. On the other hand, increases for night work would continue to be justified by the highly negative impact on health.

[2] See the contribution of Xavier Timbeau (<http://www.ofce.sciences-po.fr/blog/never-on-sunday/>)

[3] The prices in stores open on Sundays and at night, such as neighbourhood convenience stores, are already well above average, which avoids excessively subsidizing "non-standard"

customers. The higher prices in these shops are readily accepted because they correspond to a specific service. But in the case of a general elimination of regulations on working hours, it is unlikely that stores in traditional channels would spontaneously introduce price discrimination.

[4] This increase is not a tax. The formula associated with this would constitute income for the store, which would be strongly encouraged by competition to lower overall prices.

Revisions of the growth potential: the impact on deficits

By Hervé Péléraux

Public finances – battered by the Great Recession

At the end of the Great Recession of 2008/09, the fiscal problem that governments had to face was seemingly simple, as was the solution put forward. The operation of the automatic stabilizers and the stimulus packages put in place to counter the 2008/09 recession sharply increased the public deficits. This situation, which was dictated by urgency, was acceptable in the short term, but not in the longer term. Logically this would lead to an adjustment in the public accounts to reduce the deficits and halt the growth of the debt. Fiscal discipline at a forced pace under the baton of the European Commission was therefore the economic policy instrument adopted by almost all the euro zone countries.

The appropriateness of this strategy, which was undertaken to solve the initial problem, i.e. the excessive deficits in the euro zone, should nevertheless be discussed. It relied on a macroeconomic diagnosis made at the end of the recession in 2008/09 that conditioned the assessment on the spontaneous capacity for an economic recovery – in effect, the fraction of the public deficit that was likely to be spontaneously absorbed by renewed growth depended on this capacity for recovery.

Part of the deficits could be absorbed on their own

The public deficit excluding interest expense, i.e. the primary deficit, can be subdivided into two components: a cyclical component and a structural component. The cyclical component results from cyclical fluctuations in GDP around its potential, that is to say, the level of GDP achievable without inflationary pressures using the available production factors: during a phase when GDP is slowing relative to its growth potential, and thus when the output gap is widening, tax revenues slow, and public spending, in particular on social welfare, picks up. What follows is a spontaneous increase in the deficit. In economic theory this self-corrective mechanism is called the “automatic stabilizers”. The other component of the deficit is deduced from the previous one as a complement to the total deficit: this is the deliberate component, which results from the impact of economic policy. This discretionary component can be eliminated only by implementing a policy that is symmetrical to what gave rise to it, that is to say, by means of an austerity policy. By its nature it has a dampening effect on the recovery, whereas the expansionary policy during the previous phase results in boosting activity. Fiscal policy is thus an instrument for smoothing the economic cycle.

The spontaneous portion of the deficit that appeared after the 2008/09 recession was destined to be automatically reduced once growth returned. Only the elimination of the discretionary component justified a restrictive policy. The

extent of the effort needed to achieve this therefore depended on the measurement of the output gap, which conditioned the estimate of the cyclical deficit, and by inference the estimate of the deliberate deficit.

The cycle's effect on the evaluation of the potential

The measurement of the output potential that is used to calculate the output gap is obviously central for calibrating as accurately as possible the budget cuts needed to eliminate the portion of the deficit that cannot be absorbed spontaneously by growth. But policymakers face a major difficulty here, i.e. the unobservable nature of the potential, which consequently must be estimated – and economists are far from unanimous about these estimates. Moreover, periodic revisions can be significant even within the same institution, which modifies the diagnosis made and – if this institution happens to be responsible for defining the rules constraining fiscal policy, as in the case of the European Commission (EC) – the measures to be taken as well.

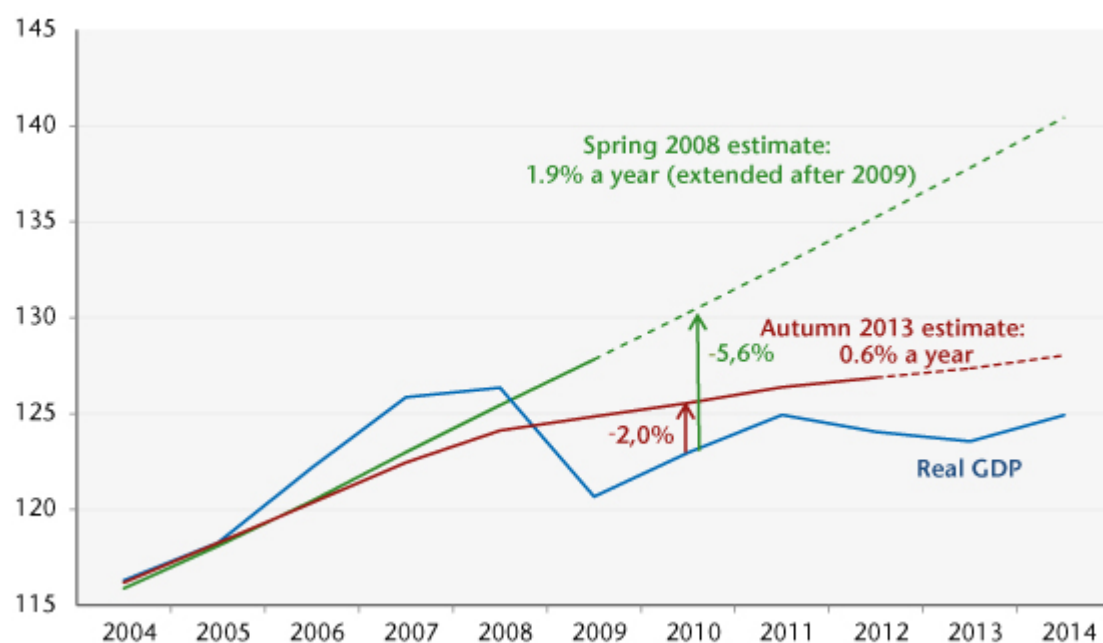
A review of the revisions of the growth potential calculated by the EC shows the uncertainty of this estimate (see last section below). The estimate also appears to depend on current growth, which is somewhat paradoxical for an estimate of a supply function that depends on long-term economic parameters such as increases in the labour force, productivity and the capital stock. It is understandable that the trajectory of these supply parameters is deflected slightly during cyclical hiccups, particularly through investment, which is a vehicle for technical progress and ensures the growth of capital or a loss in human capital due to long-term unemployment. But the fact that the inclusion in the estimates of a cyclical phenomenon, even one as massive as the recession of 2008/09, is leading to revisions of the growth potential on the order of that seen between Spring 2008 and Spring 2009 raises questions. This is particularly so as these revisions have also affected the years prior to the recession, which were not

affected by changes in the conditions of accumulation. Thereafter, the resumption of growth in 2010 led to revisions of the growth potential in the other direction, including for the years prior to the recession. Finally, the economic downturn in 2011 led to a further series of revisions, once again downwards.

Self-sustained austerity

The reduction in growth potential led to significant revisions downwards of the estimated output gap (see chart). These are not neutral for calibrating the fiscal consolidation policy. This is because for a given deficit, the estimate of the output gap of -2% for 2010, for example, versus nearly -6% under the assumption of a continuation of the trajectory of potential GDP estimated before the recession, would increase the part of the perceived structural deficit and thus call for heightened austerity. That's what happened in 2010, when the stimulus packages gave way to plans for drastic budget cuts. Generalized to all member countries, they nipped the nascent recovery in the bud and plunged the euro zone countries into a new recession.

Revision of the euro zone's growth potential



Sources: European Commission, Eurostat.

The excessive sensitivity of the estimate of potential growth to current growth precipitated the commitment to austerity policies in the euro zone and subsequently pushed towards tightening fiscal restraint further. By depressing economic activity, austerity fuelled factors that undercut supply through the destruction of capital, a slowdown in investment and deskilling the labour supply. The economies' capacity for a spontaneous recovery was thus undermined, which could only lead to an increase in the share of the structural deficit in the total deficit, and ultimately to the need for greater austerity.

The budget purge thus led to a second recession, which invalidated the deficit reduction targets set at the beginning, as the automatic stabilizers have again increased the cyclical component of the deficit. Rigour, poorly calibrated, was counter-productive and thus could not achieve the initial goal of rapid deficit reduction. The results are far from being commensurate with the sacrifices made by the European economies.

The European Commission's estimate of the euro zone's potential GDP

The 2008/09 recession led the European Commission to revise its estimate of the growth potential for the member countries rather significantly. For the euro zone as a whole, the revision process began between Spring 2008 and Spring 2009, when the effects of the financial crisis were expressed in real activity: the start of the recession in the euro zone in the fourth quarter of 2008 was associated with sharp downward revisions of the growth potential for 2008 and 2009, by -0.7 and -1.2 points, respectively (Table). There were also

relatively substantial revisions to earlier years, from -0.3 to -0.5 points for the years 2004 to 2007. However, no major revision occurs between the estimates of Spring 2009 and Spring 2010, despite the downturn in year-on-year GDP growth, indicating that the modification of the economic landscape had already been included in the estimates.

The growth potential has been revised not only downwards, but also upwards when growth picked up after the recession. Between Spring 2010 and Spring 2011, the revisions were spread from +0.1 to +0.3 points and also affected more distant years. Finally, a new series of downward revisions took place with the second economic downturn in 2011. The years prior to 2008 changed little, but they fall within a broader range for the years 2008 to 2013, from -0.2 to -0.8 points, which for 2012 amounts to dividing the potential growth rate by two and a half.

Table. Revisions of the euro zone's growth potential

	Spring 2008	Spring 2009	Spring 2010	Spring 2011	Spring 2012	Spring 2013
2004	1,9	1,6	1,7	1,9	1,9	1,9
2005	1,9	1,5	1,6	1,7	1,8	1,8
2006	2,0	1,5	1,5	1,8	1,8	1,8
2007	2,1	1,6	1,5	1,8	1,8	1,7
2008	2,0	1,3	1,3	1,6	1,4	1,4
2009	1,9	0,7	0,8	0,9	0,7	0,6
2010		0,7	0,8	1,0	0,7	0,6
2011			1,0	1,1	0,8	0,7
2012				1,1	0,6	0,4
2013					0,7	0,4
2014						0,5
GDP growth * (year on year)	1,0	-1,3	-2,1	2,0	0,7	-0,9

* The year-on-year GDP growth shown here corresponds to the latest national accounts known at the time when the estimate is made, i.e. Q4 for the preceding year for the European Commission's Spring estimate. These figures are calculated with the GDP as is known at the time, i.e. with the version available at the beginning of the month of April for each year.

Sources: European Commission, Eurostat.

The effect of current growth on the estimation of growth potential by the European Commission is thus obvious. This results in a high variability of the growth potential and therefore significant revisions of the output gap, which affects economic policy decisions since the structural balance depends on this evaluation.

